Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	

REPLY COMMENTS OF AMERITECH IN RESPONSE TO FOURTH FURTHER NOTICE OF PROPOSED RULEMAKING

Ameritech submits these reply comments in response to the Commission's Fourth Further Notice of Proposed Rulemaking in this proceeding.[1] In general Ameritech supports USTA's reply comments, especially in their rebuttal of AT&T's, Ad Hoc's, and MCI's comments.

I. AMERITECH SUPPORTS THE USE OF TOTAL FACTOR PRODUCTIVITY AS CALCULATED BY CHRISTENSEN FOR THE BASIS OF ANY PCI ADJUSTMENT FACTOR.

As USTA points out in its reply comments, the Commission should ignore the comments of those who would have the Commission base the productivity adjustment on factors other than those that are "economically meaningful". It is not appropriate to use this proceeding simply to lower LEC access rates. Rather, the productivity offset factor should only be reflective of local exchange carrier ("LEC") productivity.

Nothing submitted in the comment round of this proceeding impugns adoption of the TFP methodology, as revised and simplified by Christensen, as the appropriate measure of LEC productivity to form the basis for any PCI adjustment factor. As the record demonstrates, the TFP methodology has been simplified by USTA and

[1] In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Fourth Further Notice of Proposed Rulemaking, FCC 95-406 (released September 27, 1995) ("Fourth FNPRM").

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Christensen in response to the issues raised by the Commission in the Fourth FNPRM. The simplified study is consistent with objectives established by the Commission: It is based on sound economic theory; it ensures that productivity gains are passed through to access customers; and it is reasonably simple and uses public and verifiable data.

Ameritech also believes that the method offered by GTE for setting the PCI adjustment factor is sound.[2] The method as understood by Ameritech would eliminate the X-factor entirely and instead directly calculate a PCI adjustment based solely on the percentage change of local exchange carrier ("LEC") input prices and LEC TFP. [PCI Adjustment Factor = LEC Inflation - LEC TFP]. Specifically, GTE proposes to set the PCI adjustment factor for the upcoming tariff year by forecasting the next point in the data series produced by subtracting LEC TFP from LEC input price. All data needed for this method or any other direct method should be a result of the simplified Christensen study as filed by USTA in this proceeding. This particular method would effectively smooth the volatility associated with the LEC input price series. Application of this direct method would greatly simplify the calculation of the PCI adjustment by eliminating economy-wide data on inflation and productivity. It would also address the Commission's concerns regarding the proper treatment of LEC input inflation[3] and render the issue of input price differential moot. Moreover, it would meet all of the Commission's previously noted criteria: it is economically meaningful; it flows through productivity gains; and it is based on publicly accessible and verifiable data.[4]

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[2] GTE at 25-31.

[3] Fourth FNPRM at ¶¶ 54-56.

[4] Regardless of whether a variation of the direct method is used or whether input price differential is incorporated into the existing formula, the volatility of the input price component needs to be smoothed to avoid any disruption to carriers and customers that would result from wildly fluctuating PCI values.

II. AMERITECH SUPPORTS SOUTHWESTERN BELL'S PROPOSAL TO REPLACE THE SPECIAL CCL CAP WITH AN API CALCULATION.

As noted by Southwestern Bell in its comments,[5] use of the TFP methodology in calculating PCI adjustment factors eliminates the need for any unique carrier common line rate cap factor. The productivity effects of the growth in CCL minutes of use demand is already reflected in the TFP methodology. Therefore, the additional demand adjustment currently included in the PCI for the common line basket should be eliminated. The current CCL rate formula can then be replaced by a simple PCI formula and API calculation identical to those in other baskets. Further, this simplified approach to capping CCL rates sets a framework for the Commission's consideration of potentially permitting the increase in end user common line ("EUCL") rates and the recovery of CCL revenue in other ways since it would allow greater flexibility than exists currently within the common line basket.[6]

III. PRESCRIBED DEPRECIATION RATES ARE PROBLEMATIC.

MCI argues that the Commission should use the currently prescribed depreciation rates in any TFP study.[7] In support of its position, it introduces a study by Microeconomic Consulting & Research Associates, Incorporated ("MiCRA") which purports to prove that LEC claims of the distorted effects of regulatory depreciation

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[5] Southwestern Bell at 35-36.

[6] With the interconnection and unbundling obligations of incumbent LECs contained in the Telecommunications Act of 1996, there is a vital need for the Commission to permit all incumbent LECs to recover any subsidy costs in a competitively neutral manner. See also Section VI, infra.

[7] MCI at 18.

practices are wrong. However, as demonstrated by the paper by Technology Futures, Inc., included with USTA's Reply Comments, MiCRA's analysis is fatally flawed.

MiCRA's theoretical reserve study contains several errors which lead to false or misleading conclusions. For instance, MiCRA performs no new analysis regarding the appropriate life and depreciation patterns of LEC assets. MiCRA simply assumes the FCC's life and salvage results to conclude that there is no reserve "problem." This is to be expected. Starting with the Commission's assumptions, one would expect MICRA to wind up with answers consistent with those assumptions. However, the logic is circular and the problem is with the Commission's assumptions in the first instance.

Conveniently ignored by MiCRA is the fact that MCI uses depreciation factors that produce rates approximately 20 - 30% higher than LECs who use substantially the same equipment to provide functionally identical services and the fact that the FCC's prescribed rates for AT&T are substantially higher than those applied to LEC investment for similar equipment providing essentially identical functions. MiCRA illogically implies that the archaic rules used to calculate LEC profits, different as they are from those used to calculate IXC profits, should be maintained indefinitely.

The real lesson to be learned from MiCRA's analysis is that, at a minimum, the FCC should alter its rules so that all carriers will be measured by the same depreciation factors. Optimally, the Commission should exercise the authority granted it under the Telecommunications Act of 1996 and eliminate depreciation prescriptions for all price cap carriers.[8]

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[8] See also Section V, infra.

IV. THE TELECOMMUNICATIONS ACT OF 1996 ALTERS THE FUNDAMENTAL ASSUMPTIONS UNDERLYING BASELINE PRICE CAP REGULATION.

In addressing the PCI adjustment factor in this proceeding, the Commission's focus is on improving a regulatory mechanism for "baseline" price caps which could be applied to a "monoply" LEC access environment that has not changed since Divestiture. The assumption, however, that there would be any such environment -- especially for price cap LECs -- is no longer valid in light of the Telecommunications Act of 1996, which, in one dramatic blow, swept away all artificial barriers to entry by competitive providers of local exchange and exchange access services.

Ameritech agrees with USTA's assessment that, even without reference to the new legislation, sharing and the customer productivity divided ("CPD") should cease to be a part of price cap regulation. However, the Act by itself constitutes sufficient justification for the elimination of the CPD and any premium for no-sharing. In its First Report and Order in this docket,[9] the Commission required price cap LECs to pay a "premium", in the form of an X-factor 1.3% higher than the base factor, in exchange for no-sharing. This was done to encourage productivity increases and the sharing of those increases with customers via lower rates. Similarly, the Commission included the 0.5% CPD in the current interim X-factor options.[10] In both the "premium" demanded of carriers for no sharing and the "dividend" to customers contained in the CPD, the Commission was attempting to mimic the rate lowering effects of competition. Neither are appropriate any longer in the environment created by the Act. All incumbent LECs

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[9] In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, FCC 95-132 (released April 7, 1995) ("First Report and Order").

[10] First Report and Order at ¶¶ 209-214.

now pay the "premium" associated with the extensive obligations created in Sections 251(c) and 252 (except for those rural and small LECs that receive an exemption) and all customers will now benefit from the competitive environment created by the elimination of entry barriers. Given that fact, no-sharing should simply be included in the baseline price cap model for those carriers subject to the rigorous requirements of the Act, and the specific CPD should be eliminated.

Moreover, as competition grows, LEC productivity will decrease initially as LEC revenue/output is subject to competitive pressure.[11] This fact also mitigates against requiring a higher productivity offset in exchange for no-sharing.

V. THE COMMISSION SHOULD TAKE THIS OPPORTUNITY TO ELIMINATE UNNECESSARY REPORTING REQUIREMENTS.

Ameritech concurs with Southwestern Bell's assessment that the elimination of sharing more than justifies the elimination of reporting requirements that evolved under cost of service regulation. Specifically, price cap LECs should not be subject to the Commission's Part 65 rate of return monitoring rules and the requirement to file Form 492a used to calculate sharing. Also Sections 61.42(f) and 65.1(b)(3) should no longer apply rate of return to services excluded from price caps. Obviously, and consistent with Section 402(b)(2) of the Act, quarterly ARMIS reports should be eliminated. On remaining reports, lines associated with rate of return calculations and lines that report cost allocations not used in interstate ratemaking should be eliminated.

[11] See report of Christensen filed with USTA's comments, May 9, 1994.

VI. IN LIGHT OF THE TELECOMMUNICATIONS ACT OF 1996, THE COMMISSION SHOULD GIVE PRIORITY TO RESOLVING ISSUES RAISED IN THE SECOND FNPRM.

Because the Act vaporizes what may have previously been considered entry barriers for competitors of LEC services, in the price cap area the Commission should focus its priorities on the appropriate modifications that should be made to baseline price cap regulation in the presence of competitive pressures on LEC access services. Given the fact that competitive entry now will be based solely on appropriate economic criteria, it is imperative that the Commission permit price cap LECs to respond to this competitive pressure and commence sending appropriate economic signals to the market by pricing their services accordingly.

As Ameritech noted in its comments in response to the Second FNPRM in this docket, supply elasticity should be <u>the</u> key determinant of when streamlining is appropriate.[12] Under Ameritech's second test of when streamlining is appropriate, acknowledgment is given to the fact that supply elasticity is high when entry barriers are low. The conditions indicative of low entry barriers must now be present, by law, everywhere they are requested (except for exempt carriers). Specifically, those conditions are listed in Ameritech's Second FNPRM comments and Ameritech's initial comments in response to the Fourth FNPRM -- namely:

1) The availability of certification for competing local exchange carriers;
2) The availability of unbundled loops and ports;
3) The availability of interconnection of competing LEC networks, including reciprocal compensation;
4) The availability of interim number portability;
5) The availability of numbering resources to competing LECs,

[12] Under this analysis, of course, LEC interexchange services should be streamlined immediately.

The only remaining element of Ameritech's test is that the viability of competition be verified by the operational presence of one competing LEC. All of these criteria have been met in certain areas already and, with the pro-competitive encouragement of the Act, will quickly be met in many more. In this light, it is essential that the Commission focus, not on the appropriate method of regulating LEC services in a monopoly environment, but rather on the appropriate adaptation of that regulation to the new competitive regime.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Todd H. Bond do hereby certify that a copy of the foregoing REPLY COMMENTS OF AMERITECH IN RESPONSE TO FOURTH FURTHER NOTICE OF PROPOSED RULEMAKING has been served on the parties listed on the attached service list, via first class mail, postage prepaid, on this 1st day of March 1996.

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